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IMPLICATIONS OF THE EURO FOR UNIDO

Report by the Director-General

Reports on the budgetary, operational and financial aspects of the adoption of a single-currency system of assessment based on the euro, in compliance with decision IDB.21/Dec.8.

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Introduction

1. At its fifteenth session, the Programme and Budget Committee adopted conclusion 99/1, in which it decided to add an item to the agenda of its fifteenth session entitled "Implications of the euro for UNIDO", to be the sole item of discussion at a resumed session on 23 June 1999. At its resumed session, the Committee considered a note by the Secretariat on implications of the euro for UNIDO that contained a memorandum on that subject submitted by the European Union (PBC.15/15-IDB.21/29). After taking note of the document, the Committee decided to refer the matter to the Industrial Development Board at its twenty-first session for its consideration.

2. The Industrial Development Board, at its twenty-first session, took note of documents IDB.21/29 and IDB.21/14/Add.1, and requested the Director-General to prepare, before 15 September 1999, a report examining budgetary, operational and financial aspects of the adoption of a single-currency system of assessment based on the euro, for the fiscal period 2002-2003 and in future bienniums (IDB.21/Dec.8). The Board also enlarged the mandate of the intersessional working group on proposed amendments to the financial regulations to discuss all aspects of the possible adoption of a single-currency system of assessment based on the euro, and requested the group to submit its conclusions to a resumed twenty-first session of the Board, for submission to the eighth session of the General Conference, with a view to taking appropriate action and a decision.

3. The present document is submitted in compliance with the above Board decision. In addition to examining budgetary, operational and financial aspects, the report provides information on the euro, action taken by UNIDO, the present split-currency system of assessment, and practices in other United Nations organizations and specialized agencies. In this connection, reference may be made to a 1987 review of alternative systems of stating budget estimates and assessing Member States and relevant experience within the United Nations system (PBC.3/10).

I. THE EURO

4. The euro was introduced with effect from 1 January 1999 to replace the national currencies of eleven participating countries: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. With this introduction, the Austrian schilling has become a sub-unit of the euro and the exchange rate between the schilling and euro has been fixed at euro 1 = ATS 13.7603. Any amount in schillings can now be converted into euros and vice versa without being considered as a foreign exchange transaction. The single currency means that there is now only one monetary policy with one interest rate for all 11 Euro Zone economies, whereas previously there were 11 independent monetary policies.

5. Euro notes and coins will be introduced on 1 January 2002. The Austrian schilling will, therefore, continue to exist alongside the euro until 31 December 2001, i.e. until the end of the transition period. On 1 January 2002, the process for the replacement of schillings will start, which must be concluded within six months, and by 1 July 2002 the schilling will be fully replaced by the euro.

6. During the transition period, there is a policy of "no compulsion; no prohibition", which means that there is complete freedom to use the euro and/or the national currency for the purpose of transactions. However, there will be no such option effective 1 January 2002, and all accounts, contracts, financial balances, etc. will be converted into euros by law.

7. The transition period is being used by the participating countries to prepare for the replacement of their national currencies by the euro. Many changes are already visible, as financial institutions, suppliers, vendors, etc. have started providing/displaying information in the national currencies as well as in euros. Many suppliers/contractors have also started invoicing in euros.

II. ACTION TAKEN BY UNIDO

8. UNIDO has been taking necessary actions to introduce the euro and to fully replace the Austrian schilling by the end of 2001. Actions taken to date include:

(a) Funds received in schillings are being acknowledged both in schillings and euros;

(b) Member States are being informed of their obligations in both currencies (i.e. schillings and equivalent euros);

(c) Requests for payment in euros are being honoured in that currency;

(d) Member States' obligations to the regular budget for the biennium 2000-2001 have been shown in Austrian schillings and euros;

(e) Assessment letters have been amended to reflect both currencies;

(f) Review initiated of necessary modifications to the financial regulations resulting from the disappearance of the schilling (also specified in paragraph 8 of document IDB.21/3-PBC.15/3).

9. Further action by UNIDO depends on whether Member States decide that UNIDO should continue with the split-currency system of assessment, or move to a 100 per cent euro-based system. Implications of both scenarios are discussed in paragraphs 18 to 39, and are summarized in annex I to the present document.

III. SPLIT-CURRENCY SYSTEM OF ASSESSMENT

10. Until the end of the biennium 1986-1987 (in its first biennium as a specialized agency), UNIDO had a single-currency system of assessment based on the United States dollar. Serious problems emerged when the dollar depreciated by some 34 per cent against the Austrian schilling (from USD 1 = ATS 17.50 in January 1986 to ATS 11.50 by December 1987). Since most expenditures were (and are) in Austrian schillings/euros, this depreciation caused a financial crisis for the Organization. A supplementary estimate of $3.1 million for the 1986-1987 regular budget had to be approved to offset the net shortfall of resources resulting from the depreciation of the dollar (GC.2/Dec.20).

11. To avoid a recurrence of such a situation and to reduce the impact of exchange rate fluctuations in general, the governing bodies of UNIDO approved a split-currency system of assessment effective 1 January 1988. Under this system Member States pay their contributions in the currency of actual expenditures (GC.2/Dec.21 and GC.2/Dec.22). Thus, the Organization is not exposed to any major problems resulting from exchange rate fluctuations. Based on the system in effect since 1988-1989, the dollar and schilling/euro contributions are set at 18 and 82 per cent respectively in the current biennium, and also form the basis for the programme and budgets for 2000-2001.

12. In budgetary terms, the split-currency system effectively resolves the problem of currency fluctuations in that it fixes the amount Member States are obliged to pay in dollars and in local currency (schillings/euros) at the level of the estimated requirements of UNIDO for these currencies. Thus, at the time of budget approval, Member States commit themselves to providing the resources required for the work programme. The main features of the split-currency system of assessment are:

(a) Obligations of Member States are fixed in two main currencies of expenditures;

(b) Budget estimates are prepared using the currency considered best suited to each type of expenditure;

(c) For budget presentation, local currency (schillings/euros) is converted into United States dollars at a specified rate of exchange (USD 1 = ATS 12.90) selected for ease of comparing estimates for a given year with budget for previous years;

(d) Appropriations and assessments of Member States are established in two currencies: one amount in local currency (schillings/euros) equal to expected local currency requirements and remainder in United States dollars;

(e) Risk of loss from foreign exchange is minimized.

13. Difficulties arising from the split-currency system include:

(a) Budget preparation is cumbersome owing to the need to determine in advance the ratio of schillings/euros and dollars;

(b) For budget performance monitoring, schilling expenditures are converted to dollars at the rate applied in the budget (USD 1 = ATS 12.90), whereas the same expenditures are recorded in the accounts at the monthly United Nations rate of exchange applicable at the time of payment, thus complicating analysis and comparison;

(c) The recording of transactions at the budget rate and the United Nations rate of exchange results in book gains and losses, further complicating analysis.

Effect on assessed contributions

14. At present, Member States are assessed 18 per cent of the approved regular budget in United States dollars and 82 per cent in Austrian schillings/euros. In accordance with financial regulation 5.5(e), Member States are required to pay their assessed contributions in dollars or Austrian schillings provided that any payment shall be credited on a pro-rata basis to the dollar and schilling obligation at the United Nations rate of exchange in effect at the time the payment is received. Member States are subject to the following types of exposure:

(a) Their payments must cover 18 per cent dollar and 82 per cent schilling/euro contributions;

	Organization	Currency of assessment	Currency of accounting/reporting
Split currency	IAEA, UNIDO	USD and ATS	USD
	UNESCO	FRF and USD	USD
Single currency	CTBTO, FAO, ICAO, UN, WHO	USD	USD
	ILO	CHF	USD
	IMO	GBP	GBP
	ITU, UPU, WIPO, WMO	CHF	CHF
	OPCW	NLG	NLG

(b) Should both the dollar and schilling/euro contributions not be received during the same month, exchange losses/gains result from the application of the United Nations rate of exchange, thus leading to either an additional payment to be made by Member States, or an overpayment that is applied to the following year's assessed contributions. This often requires explanation from the Secretariat.

15. Outstanding assessed contributions in schillings are periodically converted to dollars using the applicable monthly United Nations rate of exchange. Therefore, outstanding amounts fluctuate from month to month without a real change in contributions, rendering comparison difficult.

IV. OTHER ORGANIZATIONS

16. Practices in some United Nations and other international organizations are summarized above. As can be seen, there is no uniformity and organizations have adopted different practices depending on their requirements or decisions by their governing bodies. The following table shows a number of organizations applying respective split-currency and single-currency systems, and annex II shows in tabular form the currencies of assessment and of accounting and reporting, proportion of expenditures in currencies and how exchange gains and losses are handled, including protective measures.

17. The United Nations International Drug Control Programme (UNDCP) does not have a system of assessment, as the budget is financed from voluntary contributions, with accounting and reporting in United States dollars.

V. THE ISSUE

18. In addition to the action already taken (para. 8), certain adjustments will be required to address the change from schillings to euros following the transition period, i.e. effective 1 January 2002. It should be emphasized that the 82 per cent now in Austrian schillings must inevitably be changed to euros effective 1 January 2002. However, the key issue relates to the split-currency system of assessment presently in use versus the single-currency system based on the euro. In other words, the question is whether the present 18 per cent of the budget and assessed contributions in United States dollars should also be budgeted and assessed in euros.

A. Replace schillings with euros under the split-currency system

19. Should Member States decide that UNIDO should remain with the split-currency system of assessment, the implications for the budgetary, operational and financial aspects would be minimal. A number of changes, as elaborated in paragraph 8, have already been introduced. There would be no implications for current budgetary practices or financial aspects other than amending the financial regulations to replace references to the Austrian schilling by the euro. Limited changes in the computerized financial systems and contractual obligations would be necessary (paras. 21 and 22).

Financial regulations

20. The following financial regulations would require amendments for which approval by the General Conference would be needed:

Regulation	Current text	Proposed text	Comments
Appropriation and assessment			
5.1(d)	"Each assessment shall be established in a component in United States dollars and the remainder in Austrian schillings in direct proportion to the respective shares of regular budget expenditures determined by the Conference, upon recommendation of the Director-General, to be linked to these two currencies."	"Each assessment shall be established in a component in United States dollars and the remainder in euros in direct proportion to the respective shares of regular budget expenditures determined by the Conference, upon recommendation of the Director-General, to be linked to these two currencies."	Reference to Austrian schillings will be replaced by euros.
Collection of contributions and advances			
5.5(e)	"Contributions to the regular budget are established in United States dollars and Austrian schillings in the ratio determined in accordance with regulation 5.1(d). Payments may be made in either or both of these currencies provided that any payment shall be credited on a pro-rata basis to the dollar and schilling obligation at the United Nations accounting rate of exchange in effect at the time the payment is received."	"Contributions to the regular budget are established in United States dollars and euros in the ratio determined in accordance with regulation 5.1(d). Payments may be made in either or both of these currencies provided that any payment shall be credited on a pro-rata basis to the dollar and euro obligation at the United Nations accounting rate of exchange in effect at the time the payment is received."	References to Austrian schillings will be replaced by euros.

Computerized systems

21. Necessary changes in the computerized financial systems and reporting have been or are being made to introduce the euro. By the end of the transitional period (31 December 2001), UNIDO's financial systems are expected to be ready to use the euro instead of the schilling. These changes should be implemented as part of normal programme maintenance and system improvements, and thus the Secretariat expects to be able to handle the euro on 1 January 2002.

Contractual obligations

22. Contractual obligations and other commitments in Austrian schillings would need to be changed/converted to euros. No major problems are foreseen in this respect, as the exchange rate between the two currencies has already been fixed (effective 1 January 1999: euro 1 = ATS 13.7603).

B. Introduce a euro-based single-currency system

23. At present, UNIDO accounting and reporting are in United States dollars. The introduction of the euro as a single-currency system of assessment would have a number of budgetary, operational and financial implications.

24. The most important budgetary implication would be that both the regular and operational budgets would be prepared and presented in euros.

25. Another major implication would be that UNIDO would have to record and report financial transactions in two currencies:

(a) Euros: For the regular and operational budgets, consolidated financial statements, and reports to donors (if required);

(b) United States dollars: For extrabudgetary activities (mainly technical cooperation) and reports to donors.

26. Although the operational budget is financed through support cost reimbursement on extrabudgetary activities and income from technical services, in order to facilitate unified budgeting and accounting for both the regular and operational budgets, the latter would also have to be recorded and reported in euros. This implies that income, which is normally received in dollars, would be recorded in euros.

27. The regular budget is financed through assessments. The main features of a single-currency system would be:

(a) A system of assessment entirely in local currency would be relatively simple and straightforward in application, especially with respect to reporting;

(b) Member States would know precisely the amount of their assessed contributions at the time the assessment is levied;

(c) Most expenditures, which would be paid in euros, would be recorded and reported in the same currency.

28. Some difficulties could be expected with a single currency system, including:

(a) A residual risk from exchange rate fluctuations will always remain. A mechanism similar to those introduced by other organizations (such as a special reserve fund or forward purchasing contracts) would need to be applied to protect the Organization;

(b) A local currency-based system may complicate comparison of budgets with those of previous years and with the budgets and assessments of other organizations;

(c) UNIDO would have to introduce a dual currency accounting system in which both euros and dollars could be equally used as the base currency. A new accounting software would be required to handle transactions and present reports in both currencies (paras. 25 and 38).

Protection against exchange rate fluctuations

29. UNIDO would continue to use dollars (presently 18 per cent requirement) to meet dollar-based obligations (such as costs for the field offices or settlements with the United Nations Development Programme and the United Nations). Therefore, risks arising from exchange rate fluctuations would remain. However, it is not expected that the Organization would be exposed to significant exchange rate fluctuation risks, as experienced during 1986-1987 when the single-currency system of assessment was based on dollars and most expenditures were in schillings (paras. 10 and 11). The exchange risk could further be reduced by minimizing the current dollar-based expenditures. However, it would not be possible to eliminate all such transactions and associated risks.

30. Therefore, a mechanism would be required to protect the Organization from exchange rate fluctuations. As shown in annex II, this practice has already been adopted by a number of organizations.

31. To minimize dollar expenditures, some major items such as those listed below could be settled in euros instead of dollars, thereby reducing exposure to exchange rate fluctuations. These figures should, however, be treated with caution as negotiations and agreements with other parties would be required:

(a) Contributions to the United Nations Joint Staff Pension Fund: UNIDO pays the Fund in dollars, which represent about 5 per cent of the dollar expenditures. The Pension Fund is expected to accept these contributions in euros. This would, however, require negotiation and agreement;

(b) Staff salaries: Staff are entitled to receive a portion of their salaries in dollars, which represents about 2 per cent of the dollar exposure. Headquarters staff could be paid in euros only.

Effect on assessed contributions

32. Under a single-currency system, Member States would be required to pay 100 per cent of their assessed contributions in euros, and there would be no exposure to dollars. Should these contributions be paid and recorded in euros, no exchange gains or losses would result from the application of these payments, which would represent an improvement over the present system (para. 14).

33. Outstanding assessed contributions would be shown consistently in one currency, making information realistic and comparable.

Financial regulations

34. The following financial regulations would require amendment, for which approval by the General Conference would be needed. A number of related financial rules would also require amendment, which would be carried out by the Director-General after approval by Member States of the introduction of a single-currency system.

Financial regulation	Current text	Proposed text	Comments
Preparation of the budgets			
3.2	"The financial estimates shall cover income and expenditures for the fiscal period to which they relate and shall be presented in United States dollars."	"The financial estimates shall cover income and expenditures for the fiscal period to which they relate and shall be presented in euros."	Reference to United States dollars would be replaced by euros.
Appropriation and assessment			
5.1(d)	"Each assessment shall be established in a component in United States dollars and the remainder in Austrian schillings in direct proportion to the respective shares of regular budget expenditures determined by the Conference, upon recommendation of the Director-General, to be linked to these two currencies."	"Each assessment shall be established in euros."	References to Austrian schillings and United States dollars would be replaced by euros. Reference to split-currency element would be deleted.
Collection of contributions and advances			
5.5(d)	"Advances to the Working Capital Fund shall be assessed and paid in United States dollars."	"Advances to the Working Capital Fund shall be assessed and paid in euros."	Reference to United States dollars would be replaced by euros.
5.5(e)	"Contributions to the regular budget are established in United States dollars and Austrian schillings in the ratio determined in accordance with regulation 5.1(d). Payments may be made in either or both of these currencies provided that any payment shall be credited on a pro-rata basis to the dollar and schilling obligation at the United Nations accounting rate of exchange in effect at the time the payment is received."	"Contributions to the regular budget are established in euros."	References to Austrian schillings and United States dollars would be replaced by euros. Reference to split-currency element would be deleted.
Currency of accounts			
10.5	"The accounts of the Organization shall be presented in United States dollars. Accounts and accounting records may, however, be kept in such currency or currencies as the Director-General may deem necessary".	"The accounts of the Organization shall be presented in euros. Accounts and accounting records may, however, be kept in such currency or currencies as the Director-General may deem necessary".	Reference to United States dollars would be replaced by euros.

Staff regulations

35. No amendment to the staff regulations would be required. However, schedule I of the staff regulations referred to in staff regulation 6.1, which shows salary scales for the professional and higher categories in United States dollars, would need to be supplemented to show amounts in euros. The same principle would apply to other elements of remuneration presently shown in United States dollars, such as schedule III (staff assessment) and annex I (dependency allowances).

Exchange rate for conversion of existing dollar-based amounts

36. All assets, liabilities, fund balances and reserves–which are presently shown in United States dollars–would require conversion into euros on 1 January 2002. Most of these balances would be converted using the United Nations rate of exchange applicable at that time. However, a General Conference decision would be required to convert outstanding assessed contributions, fund balances and surpluses. In so doing, the current policy of applying the average exchange rate for the three-year period could be adopted (for instance, the average dollar/euro exchange rate during 1999 through 2001). This would be similar to the current policy for the conversion of Austrian schillings into United States dollars, under which the schilling arrears of the previous biennium are converted to dollars (IDB.7/Dec.7). (For example, the schilling arrears of the biennium 1996-1997 were converted to dollars using the average exchange rate for the three-year period 1996 to 1998.)

37. In line with established practice, the budgetary rate of exchange for the biennium 2000-2001 continued to be USD 1 = ATS 12.90. An exchange rate would be essential to convert the 2000-2001 budget to euros to ensure a realistic comparison with the budgets of future periods.

Computerized systems

38. As stated in paragraphs 25 and 28 (c) above, records and reporting would have to be in both euros and United States dollars. Specifically, the need would be to produce regular and operational budget reports and consolidated financial statements in euros, statements on extrabudgetary activities in dollars and euros, and financial statements to donors in dollars and/or euros. Therefore, an appropriate computerized financial system would have to be introduced by 31 December 2001. The work could take at least two years provided sufficient resources are made available to undertake such a task. Currently, UNIDO is evaluating various computerized information systems to improve overall performance, and a dual currency feature would become a major consideration. The scope and estimated costs of introducing a dual-currency accounting system would have to be studied.

Contractual obligations

39. Current major contractual obligations and other commitments in United States dollars–such as CCAQ, JIU, the loan from the United Nations and other inter-agency charges–would need to be negotiated with other parties for conversion to euros to the extent possible.

VI. CONCLUSION

40. The central issue is whether the 18 per cent of assessments at present in United States dollars should be assessed in euros. If Member States decide to do so effective 1 January 2002, the question of timing is critical. A decision on whether to move at that time to a euro-based single-currency system of assessment is required by the General Conference at its eighth session for the following reasons:

(a) The programme and budget proposals for the biennium 2002-2003 will have to be prepared during the period 2000-2001 for consideration by the Programme and Budget Committee and the Industrial Development Board before submission to the General Conference at its ninth session towards the end of 2001.

(b) Requisite changes in the payroll, accounting, financial and other computerized systems could take approximately two years. These changes would be essential to ensure that all systems have the facility for both euro and dollar accounting and reporting, and they would need to be introduced before December 2001.

(c) Necessary negotiation with other parties to minimize dollar exposure, and to establish a mechanism to deal with exchange rate fluctuations.

VII. ACTION REQUIRED OF THE BOARD

41. Within the framework of its decision IDB.21/Dec.8, the Board may wish to take note of the information provided in the present document, and of the conclusions to be submitted by the open-ended intersessional working group, and to make an appropriate recommendation to the General Conference.